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10 **UNITED STATES DISTRICT COURT**
11 **FOR THE DISTRICT OF ARIZONA**

12 **FEDERAL TRADE COMMISSION; all 50**
13 **states and the DISTRICT OF COLUMBIA,**

14 **Plaintiffs,**

15 **vs.**

16 **CANCER FUND OF AMERICA, INC., a**
17 **Delaware corporation, *et al.*;**

18 **Defendant(s)**

Civil Action No.: [2:15-cv-00884-NVW](https://www.courtlistener.com/doc/2015/09/23/2:15-cv-00884-NVW/)

**PLAINTIFFS' MEMORANDUM
IN SUPPORT OF RECEIVER'S
DENIAL OF CLAIM OF GRACE
COMMUNICATIONS INC.,
DBA CHARITY SERVICES
INTERNATIONAL, AGAINST
CHILDREN'S CANCER FUND OF
AMERICA; DECLARATIONS OF
ERIC SETALA AND SONJA K.
BERNDT AND EXHIBITS IN
SUPPORT THEREOF**

21
22 **I. INTRODUCTION**

23 Plaintiffs the Federal Trade Commission, All 50 States (except Oklahoma), and
24 the District of Columbia, recommend that this Court adopt the recommendation of the
25 Receiver for Children's Cancer Fund of America, Inc. ("Children's Cancer Fund" or
26 "CCFOA") and deny the claim submitted by Grace Communications, Inc., d/b/a Charity
27 Services International ("CSI"). This filing is made pursuant to paragraph 5.2 of the Order
28 Establishing Procedures for the Adjudication of Claims Against Defendants the Breast

1 Cancer Society, Inc., and Children’s Cancer Fund of America, Inc. (“Claims Order”)
2 (Doc. No. 210), which states that “[t]he Receiver, or any Claimant or other party in
3 interest may file an objection to any Claim as provided in this Order.” Given that
4 Plaintiffs have a Stipulated Monetary Judgment against Children’s Cancer Fund for
5 \$30,079,821, and that the proceeds of its liquidation are to be paid to the state plaintiffs
6 (*see* Doc. No. 13, Section VII), Plaintiffs are interested parties.

7 **II. BACKGROUND ON CHARITY SERVICES INTERNATIONAL**

8 To mask high administrative and fundraising costs, which the donating public
9 views unfavorably, Defendants in this action, including Children’s Cancer Fund, through
10 the support and efforts of CSI, embarked on an extensive scheme involving shipping gift-
11 in-kind goods (noncash goods such as pharmaceuticals) internationally. Significantly,
12 CSI explicitly promoted its gift-in-kind program as a method for Children’s Cancer Fund
13 to reduce fundraising percentages by booking large noncash gift values. (*See* Ex. 1,
14 attached to Declaration of Eric Setala [“Setala Decl.”] at p. 5, where CSI’s VP, Darin
15 Martin, tells Rose Perkins “I have a shipment [listed below] that just came in worth \$1.6
16 million. This one shipment would bring [Children’s Cancer Fund’s] cost of fundraising
17 from 85% down to 68% [based on CCFOA’s 2007 form 990].”) The vast majority of the
18 goods shipped were pharmaceuticals that, in numerous instances, could not be distributed
19 or sold in the United States. Children’s Cancer Fund’s participation in this scheme was
20 limited to paying shipping costs and broker’s fees to CSI, ostensibly to ship containers of
21 goods to organizations in developing countries – but Children’s Cancer Fund reported the
22 full value of the shipments as if the prescription medicine and other goods had been
23 donated to, and distributed by it. Defendants, including Children’s Cancer Fund,
24 exclusively used CSI, a for-profit entity, to facilitate (broker) their gift-in-kind
25 transactions.

26 CSI provided Children’s Cancer Fund with information about “available”
27 shipments of gifts in kind such as pharmaceuticals to be shipped to pre-selected foreign
28 recipients. The information CSI provided included shipping costs, the fees charged by

1 CSI, the estimated value of the shipment, the goods in the shipment, and the destination
2 and end recipient of the shipment. If Children's Cancer Fund agreed to accept the so-
3 called "donation opportunity," CSI would arrange to ship the goods and provide
4 Children's Cancer Fund with paperwork supposedly documenting Children Cancer
5 Fund's receipt of the donated gift-in-kind goods from an earlier "predecessor" donor, the
6 value of the donated goods, and Children's Cancer Fund's distribution of the goods to the
7 foreign end recipient. CSI created most of the documents for this process, including
8 documents purporting to transfer title of the donated goods from the earlier "predecessor"
9 donor to Children's Cancer Fund, documents purporting to provide values for the goods,
10 documents purporting to verify receipt of the goods by foreign end recipients, and
11 documents discussing the end recipient's purported further distribution of the goods.
12 Children's Cancer Fund then used this documentation to support reporting, as
13 contribution revenue and program expense, the value of the gifts in kind set up by CSI.
14 Plaintiffs alleged that Children's Cancer Fund's reporting of the gift-in-kind shipments
15 facilitated by CSI was deceptive. (*See* Complaint, Counts III, IV, and V [Doc. No. 7].)

16 In its Claims Report for Children's Cancer Fund, the Receiver recommended that
17 the Court deny CSI's claim, noting as follows: "Since this claim arises from activities
18 that are in support and aid of the fraudulent conduct by the Corporate Defendants that led
19 to the filing of this lawsuit and the appointment of a Receiver for Children's Cancer Fund
20 of America, the Receiver recommends denial of this claim." (Doc. 319, at p. 14.)
21 Plaintiffs concur with the Receiver's conclusion and recommendation and, for this
22 reason, file this memorandum supporting the Receiver's recommendation that CSI's
23 claim be denied.

24 **III. CSI'S CLAIM SHOULD BE DENIED.**

25 **A. The Claim.**

26 CSI timely submitted a Proof of Claim to the Receiver for payment of two
27 outstanding invoices: (1) \$11,897 that Children's Cancer Fund allegedly owed CSI on
28 Invoice #CCFOA2014-WA16, dated April 22, 2014; and (2) \$39,600 that Children's

1 Cancer Fund allegedly owed CSI on Invoice #CCFOA2014-WA39, dated October 2,
2 2014. These invoices relate to services that CSI claimed to have provided Children's
3 Cancer Fund in connection with two international shipments of gifts in kind, the values
4 for which Children's Cancer Fund originally intended to report as contribution revenue
5 and program expense in 2014.¹

6 The Receiver initially denied CSI's claim and CSI objected. With its objections,
7 CSI submitted supporting documentation to the Receiver ("CSI's Objections") purporting
8 to substantiate its claims of contractual performance. However, as discussed below, the
9 "supporting" documents filed by CSI with the Receiver illustrate the inadequacies of
10 CSI's "services" and fail to demonstrate that CSI provided Children's Cancer Fund all
11 the promised services in several critical ways.

12 Pursuant to the Claims Order, the Receiver has now filed both CSI's Objections
13 and its response, and recommended that the Court deny CSI's claim.

14 In its Objections, CSI claims that it performed all contractual services in good
15 faith, with the reasonable expectation that Children's Cancer Fund would pay the two
16 invoices at issue. The March 26, 2013 Memorandum of Understanding ("2013 MOU")
17 with Children's Cancer Fund that CSI enclosed with its Objections listed services CSI
18 was to provide Children's Cancer Fund in connection with international shipments of
19 gifts in kind. CSI's promised Administrative Support Services are stated as "Fair value
20 research," "Proof of value," "Documentation management," and "Audit support."
21 Logistics services are stated as "Obtain shipping approval from [Children's Cancer

22 ¹ Children's Cancer Fund failed to file its 2014 IRS Form 990 prior to the May 2015
23 entry of the Permanent Injunction and appointment of a Receiver. Thus, the Receiver
24 was responsible for completing the 2014 IRS Form 990. The Receiver's accountant
25 chose not to report the values of the two shipments at issue, noting "The Receiver and its
26 accounting firm cannot verify if these transactions were actual occurrences, or entries
27 fabricated to inflate the revenue and expenses designed to create the illusion that the
28 organization was larger and more efficient with donors' dollars that they actually were.
Therefore, these amounts are not reported on Form 990 or Schedule F." (Children's
Cancer Fund 2014 IRS Form 990, Form 8275, p.2, available at
<http://www.guidestar.org/FinDocuments/2014/201/226/2014-201226416-0c46e6ae-9.pdf>.)

Fund's] program partner," "Arrange shipping," "Shipping management," "Proof of existence," and "Distribution follow-up." (*See* Doc. No. 354, Ex. G, at p. 2.) These terms are vague, undefined, and unexplained, but should be construed in a manner consistent with the course of conduct between the parties as established in the original Memorandum of Understanding between the parties signed on February 13, 2009 ("the 2009 MOU"), which defined these terms in greater detail.²

In the first paragraph of the 2009 MOU, CSI declares that it is a "full service turn-key gifts-in-kind provider that functions like an in-house gift-in-kind department enabling charities to receive donated goods." It states that the charity, here Children's Cancer Fund, is in control of the donated goods throughout the entire process. The 2009 MOU further states that CSI will process the transference of title and ownership of the donated goods from the donor to Children's Cancer Fund. The 2009 MOU more specifically provides that CSI will:

- Find and process, at the request of Children's Cancer Fund, specified goods available for donation that are listed in Children's Cancer Fund's request for donation letter;
- Audit the value of the donated goods according to fair value measurements as explained by FASB 157;
- Handle the logistics and arrange the shipping and handling of Children's Cancer Fund goods to the consignee of their choice;
- Handle the processing of all documentation.

The 2009 MOU further provides in footnotes that the donations are in compliance with Financial Accounting Standards Board ("FASB") Statement Nos. 116, 136, and 157. Footnote 1 states that these donations are from *the original donor* and are given without conditions, except that they are not to be sold or bartered. The 2013 MOU did not alter

² The 2009 MOU is attached to the Setala Declaration as Exhibit 2. The authenticity of exhibits attached to Plaintiffs' Memorandum other than Exhibits 6 and 7 is established by the attached declaration of Eric Setala. The authenticity of Exhibits 6 and 7 are established by the attached declaration of Sonja K. Berndt ("Berndt Decl.").

1 the services CSI promised to provide Children's Cancer Fund in the 2009 MOU; it
2 simply shortened the explanation of those services.

3 **B. CSI Failed to Perform on Its Contractual Promises to Children's**
4 **Cancer Fund and Its Claim Should Be Denied.**

5 Under the terms of both MOUs, CSI was to provide a method by which gifts-in-
6 kind donations to Children's Cancer Fund would be processed and accounted for in a
7 legitimate and legally compliant way. CSI failed to provide the promised services and as
8 a result, as alleged in Plaintiffs' Complaint, Children's Cancer Fund did not process and
9 account for its international gift-in-kind donations in a lawful and legitimate way.

10 **1. CSI failed to provide Children's Cancer Fund with clear title**
11 **and ownership of the donated goods.**

12 CSI failed to establish that it processed the transfer of title and ownership of the
13 donated goods from *the original donor* to Children's Cancer Fund. As explained by
14 Brian C. O'Brien, an expert in accounting principles applicable to not-for-profit
15 organizations, "[a] gift in kind ['GIK'] received by a not-for-profit organization is a form
16 of contribution revenue that would be recorded by the organization as revenue if it meets
17 certain criteria for recognition as outlined within FASB ASC 958-605. Under these
18 criteria, an organization receiving GIK can recognize its value as revenue if it has
19 ownership of the GIK and is not acting as an agent or 'pass through,' i.e., it has discretion
20 ['variance power'] in using or distributing the GIK. If the organization is acting as a mere
21 agent or 'pass through' in a GIK transaction, it cannot claim ownership of the GIK and,
22 under U.S. GAAP, the organization would not record contribution revenue related to the
23 GIK." (Doc. No. 278, Ex. 11, at p. 269.)

24 While CSI's Objections included two letters from World Assist to Children's
25 Cancer Fund stating that World Assist "passes official title" of the donated goods at issue
26 to Children's Cancer Fund and grants "variance power," the October 8, 2014 letter also
27 notifies Children's Cancer Fund that World Assist is "*acting as an intermediary*" – in
28 other words, as a mere "pass through." The letter did not identify the owner of the goods

on whose behalf World Assist was acting, or otherwise explain how World Assist had such authority. CSI submitted no documents for either shipment from the pharmaceutical companies, the *original donors* of the medicines, giving unconditional ownership of the goods and variance power to World Assist or any other charity on whose behalf World Assist might be acting. Thus, there is nothing to show that World Assist had variance power³ and ownership authorizing it to pass variance power and ownership on to Children's Cancer Fund. Such authority would have been required to allow Children's Cancer Fund to claim these multi-million-dollar shipments as revenue and program expense in its financial reporting. Accordingly, CSI failed to provide the promised services.

2. The end user of the goods was not chosen by Children's Cancer Fund.

CSI agreed to "process the transference of the title and ownership of the donated goods from the donor to Children's Cancer Fund." However, as discussed above, in order for Children's Cancer Fund to claim the donated goods as contributions revenue and program expense, it was also required to have variance power. CSI's own procedures, however, *precluded* Children's Cancer Fund from having variance power and ownership of the goods because CSI "offered" Children's Cancer Fund shipments where the end user was pre-selected. If the end user of the goods in question was chosen by someone *other* than Children's Cancer Fund, then Children's Cancer Fund would not have variance power. (Document 278 [Stephen Daves Deposition], Ex. 4, at p. 127, (145) line

³ Variance power is the ability to determine who the end user of a gift in kind will be. The concept of variance power is discussed at length in the deposition of Stephen Daves, Children's Cancer Fund's accountant from at least 2008 to 2012, and for co-defendant Cancer Fund of America ("CFA" or "CFOA" in some exhibits) who used CSI's services in CFA's gift-in-kind program. (Doc. 278, Ex. 4, at p. 97, [28] lines 12-22, & p. 100, [39] lines 9-17.) The discussion of variance power and the fact it is *required* in order for a charity to claim the value of gifts in kind as revenue and program expense in regulatory filings is at Document 278, Exhibit 4, at page 127, [145] line 13 through Document 278, Exhibit 4, page 128, [149] line 12. Attached to the Berndt Declaration as Exhibit 3 is the executed signature page for the deposition transcript along with a cover letter from Mr. Daves' attorney noting that Mr. Daves made no corrections to the transcript.

4 through p. 128, (149) line 9.) Emails from CSI show that, when CSI personnel offered shipments to Children's Cancer Fund, the end user (foreign organization) was already identified. (See Ex. 3, where in May 2009, CSI's Darin Martin offers Children's Cancer Fund a shipment of goods worth approximately \$863,400 and tells Rose Perkins that the shipment is going to an organization in Northern Iraq; Ex. 4, where in February 2010, Martin offers Children's Cancer Fund and co-defendants Cancer Fund of America and The Breast Cancer Society pharmaceuticals worth an estimated \$2,007,902.05 per charity, and tells them that this shipment is going to the Order of Malta charity in Guatemala; Ex. 5, where, in July 2010, Martin offers Children's Cancer Fund a shipment worth approximately \$700,000 that is going to the Hope of Life charity in Guatemala.)⁴

CSI could not warrant that Children's Cancer Fund would have variance power and ownership where the end user had already been selected by another entity. Accordingly, because CSI failed to provide the promised services, Children's Cancer Fund was not allowed to claim the huge values of the goods as revenue and program expense in its financial reporting.

3. **CSI provided no proof of valuation for shipment WA39.**

In its Objections, CSI failed to submit any proof of valuation for shipment WA39. The Objections include a proof of valuation for shipment WA16. (There is a *proof of existence* for WA39, *but no valuation*.) Both the 2009 and the 2013 MOUs require CSI to provide "Proof of Value." For WA39, with regard to the pharmaceuticals, there are pages entitled "Red Book Online Product Details," but no computed valuation at all. Thus, there is no evidence that CSI performed any valuation services related to shipment WA39 for which it was due compensation.

⁴ CSI also used the same process with co-defendant CFA. Emails between CSI personnel and CFA personnel were introduced and discussed during the Daves deposition. Accountant Daves noted that, if the end user was already identified in CSI's offer of the shipment to CFA, CFA would not have had variance power and would not have been able to claim the value of the shipment as contribution revenue or program expense. (Doc. No. 278, Ex. 4, at p. 136, (183) line 25 through p. 137, (187) line 9.)

1 4. **CSI provided no proof that it audited the value of the donated**
 2 **goods according to applicable fair value measurements.**

3 a) *No consideration of expiration dates.*

4 CSI's Objections also did not include any documentation showing that it "audited
 5 the value of the donated goods according to fair value measurements as explained by
 6 FASB 157." Such audit services were required by its MOUs. FASB Statement 157 *Fair*
 7 *Value Measurements* is now codified as FASB Accounting Standards Codification (ASC)
 8 Topic 820 *Fair Value Measurement*. ASC Topic 820 defines "fair value" as "the price
 9 that would be received to sell an asset or paid to transfer a liability in an orderly
 10 transaction between market participants at the measurement date." (See Ex. 7, Topic 820,
 11 ¶ 820-10-35-2.) Topic 820 further provides that "when measuring fair value, a reporting
 12 entity shall take into account the characteristics of the asset or liability at the measuring
 13 date. Such characteristics include, for example, the following: (a) the condition and
 14 location of the asset" (Ex. 7, ¶ 820-10-35-2B.)

15 CSI failed to comply with Topic 820's fair value measurements because, for
 16 shipment WA16, none of the pharmaceuticals listed in the documents called "Proof of
 17 Existence" and "Donor's Inventory" has any expiration dates on them. The expiration
 18 date of a pharmaceutical is a condition that "market participants" would consider in
 19 valuing the medicine. The failure to include the expiration dates renders the valuation
 20 CSI provided for WA16 meaningless. Value could not be established for the medicines
 21 that were included in that shipment because CSI failed to show that the medicines were
 22 safe and effective and that any values given would comply with Topic 820.

23 As for shipment WA39, CSI submitted with its Objections a "Customs Packing
 24 List" erroneously labeled as related to shipment WA16. The items listed on the Customs
 25 Packing List match the items listed on the inventory for WA39, not the items listed in the
 26 inventory for WA16. While the Customs Packing List for shipment WA39 notes
 27 expiration dates for the pharmaceuticals, these dates show a short window of time before
 28 expiration. According to the shipping report submitted by CSI, shipment WA39 did not

1 arrive in Guatemala until late October 2014 and, of course, additional time was required
 2 to distribute the medicines to the end user clinics and patients. Since CSI failed to even
 3 submit a valuation for this shipment, there is, of course, no indication that CSI considered
 4 the short expiration periods of the pharmaceuticals in compliance with Topic 820.

5 *b) CSI's Audited values based on Red Book are insufficient.*

6 CSI's Objections also failed to demonstrate that it provided Children's Cancer
 7 Fund with "audited values of donated goods according to fair value measurements" for
 8 either shipment. Topic 820 requires a reporting entity to use valuation techniques "that
 9 are appropriate in the circumstances and for which sufficient data are available to
 10 measure fair value, maximizing the use of relevant observable inputs and minimizing the
 11 use of unobservable inputs." (Ex. 7, ¶ 820-10-35-24.) The only support for valuation of
 12 the pharmaceuticals that CSI provided with its Objections are pages from "Red Book
 13 Online Product Details." CSI failed to submit any evidence that reliance solely on the
 14 "Red Book" is sufficient to establish the multi-million-dollar valuations for
 15 pharmaceuticals as required by Topic 820. Thus, CSI did not establish that it provided
 16 any audit services for which it was due compensation.

17 **5. CSI failed to provide reports of end-user distribution of the**
 18 **goods.**

19 Finally, CSI's Objections failed to include *any* reports of the end user's
 20 distribution of the goods included in the shipments in question. CSI had promised,
 21 however, to process goods donated to Children's Cancer Fund from the original donation
 22 through the final distribution in the foreign country (end user), and to handle the
 23 processing of all documentation. (Ex. 2.) The only document CSI submitted with its
 24 Objections related to end-user distributions is for a different shipment number and
 25 appears to relate to a charity called "Diabetes Research and Wellness Foundation."⁵ So
 26

27 ⁵ See Doc. No. 354, Ex. G, at pp. 70-74. The shipment number referred to in the report
 28 CSI submitted to the Receiver is DRWF2014-WA35. The shipment reference numbers
 for the invoices at issue in CSI's Claim are CCFOA2014-WA39 and CCFOA2014-
 WA16.

1 *the only distribution report CSI submitted to the Receiver is for a shipment CSI processed*
2 *for some other charity.* The photographs CSI submitted with its Objections, alone, do not
3 constitute evidence of distribution because they only show undistributed boxed goods
4 located in unknown locations, at unknown dates.⁶ There is simply no evidence that the
5 pharmaceuticals arrived at the specified destinations, or that they were distributed and
6 used by anyone. Here too CSI failed to establish that it provided Children's Cancer Fund
7 with the promised services or that it is due compensation.

8 **IV. CONCLUSION**

9 CSI's failure to provide promised services when acting as Children's Cancer
10 Fund's "full service turn-key gifts-in-kind provider" in large part caused Children's
11 Cancer Fund to unlawfully report, as revenue and program expense, hugely over-valued
12 gift-in-kind shipments that Children's Cancer Fund did not own, thus deceiving
13 regulators and the donating public. CSI's activities supported and aided Children's
14 Cancer Fund's fraudulent conduct in reporting false, substantially inflated revenue and
15 program expense numbers and false, inflated efficiency ratings in regulatory filings, in
16 solicitations and in other publicly available materials. It should not be compensated for
17 assisting in this unlawful conduct.

18 For all of these reasons, Plaintiffs respectfully request that this Court follow the
19 recommendation of the Receiver and deny CSI's Claim for compensation in this
20 Receivership proceeding.

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27 ⁶ Plaintiffs also note that CSI's documentation of other items did not match. For example,
28 CSI submitted pages of *valuation information* for Crocs Kids Classic shoes, but CSI's
inventories for the two shipments included only shoes manufactured by Sketchers, not
Crocs shoes.

1 RESPECTFULLY SUBMITTED this ____ day of September, 2016.

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3
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CERTIFICATE OF SERVICE

I certify that on September ____, 2016, I electronically transmitted the attached document to the Clerk's Office using the CM/ECF System for filing and transmittal of a Notice of Electronic Filing to all CM/ECF registrants and *e*-mailed a copy of same to any non-registrants.

/s/ Matthew du Mee

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